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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1937

No. 21

HERMAN C. GROMAN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

SUPPLEMENTAL BRIEF FOR PETITIONER

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With our petition for writ of certiorari in this case we filed a complete brief on the merits (including the prescribed statements as to the opinions below, jurisdiction, specification of errors, etc.), and had intended to stand thereon, since the time for the filing of a brief for respondent would not allow for the filing of a reply within the time allotted us.

However, the Commissioner's brief has now been filed in the case of *Helvering* v. *Bashford,* (No. 33, October Term, 1937), and in view of the similarity of the two

cases we anticipate that the position taken by the Commissioner in our case will be substantially the same as he has asserted in the *Bashford* case. This gives us the opportunity of discussing here what we assume will be the Commissioner's contentions, which we shall attempt to do without reiteration of the argument contained in our original brief.

Summary of Supplemental Argument.

POINT I. The provisions of the reorganization sections do not create a statutory exemption, but are in their nature administrative, and merely postpone the imposition of the tax until the time when income is actually realized. The position taken by the Commissioner, that a corporation may not be a party to a reorganization within the meaning of Section 112(b)(3) unless it itself has performed some of the acts specified in Section 112(i)(1), is without support in any statutory language or any authoritative judicial interpretation, and is not sound in reason. Whether the acts described in Section 112(i)(1) have occurred is a circumstance which determines whether there has been a reorganization. When it is determined that a reorganization has occurred, then the question whether a corporation is a party thereto is to be determined by its participation, and whether its exchanged securities represent a continuing definite substantial interest in the earning power of the transferred assets.

POINT II. In the instant case Glidden was a party to the reorganization even within the unwarrantedly restricted interpretation for which the Commissioner contends, since it did in fact perform part of the acts by which all the stock of Indiana was acquired by Ohio, namely, the issuance and delivery to Indiana stockholders of Glidden's prior preference stock, and the guaranty

by Glidden of dividends upon and redemption of the preferred stock of Ohio.

POINT III. In the instant case Glidden, through its instrumentality and *alter ego,* Ohio, whose corporate entity should be disregarded, did itself acquire all the stock of Indiana. The statutory definition of "control" has no application to the question of disregarding the corporate entity.

Supplemental Argument.

POINT I.

THERE IS NO SUPPORT FOR THE COMMISSIONER'S POSITION THAT THE ONLY PARTIES TO A REORGANIZATION ARE THOSE PERFORMING THE ACTS SPECIFIED IN SECTION 112(i)(1).

Throughout the discussion of this question in the brief of the Commissioner in the *Bashford* case, it seems to be assumed that the provisions of the reorganization sections of the taxing acts constitute an *exemption* from taxation of the taxpayer so affected. At page 12 of the brief the words "statutory exemptions" are specifically used. The principle of strict construction contended for is applicable where exemptions from taxation or deductions from income are sought to be availed of by the taxpayer, and both cases cited in the Commissioner's brief (*Burnet* v. *Houston,* 283 U. S. 223; *New Colonial Company* v. *Helvering,* 292 U. S. 435) are of this character.

But the provisions of the reorganization sections are not within this category. They do not grant exemptions nor do they relieve the transactions there involved of the burden of taxation, nor create deductions from income. Their primary purpose is administrative; they furnish a criterion for determining when income shall be treated as realized, and postpone the incidence of the tax until

that date when the gain is, in fact, realized. This question is specifically discussed in the decision of the Circuit Court of Appeals for the 8th Circuit in *Helvering* v. *Minnesota Tea Company,* 89 F. (2d) 711, after the remandment of that case by this court. In that opinion the court said:

> "The provisions [of the reorganization sections] that no gain or loss is recognized from certain exchanges do not grant an exemption and are not so intended, but operate only as a postponement of the tax until gain is clearly realized by a future sale or exchange amounting thereto."

The brief filed for the Commissioner in the *Bashford* case, while conceding that the language of Section 112 (i) (2) with respect to a party to a reorganization is not all-inclusive, exhibits all through the brief, it seems to us, a confusion of thought in referring to this language as a "definition." (Pages 15, 17, 21.) This question is fully argued in our original brief at pages 14 to 20, and we believe it is demonstrable, and there demonstrated, that this section does not attempt to "define" a party to a reorganization, but only to "enumerate certain cases with respect to which doubt might arise."

The Commissioner's fundamental position seems to be that a corporation cannot be "a party to a reorganization" within the language of Section 112(b) (3) unless it itself performs one of the specific acts defined in Section 112(i) (1), and we believe this to be a basic misconception, unwarranted by anything in the statute or any supporting interpretation of it. And the Commissioner's brief does not seem to us to state any reason why this should be the construction, but merely to assert that the statute should be so construed.

As we view it, Section 112(i) (1) must be complied with by some one or more corporations in order that

there may be a reorganization. When there has been a merger or consolidation (including the enlargement of those terms by the parenthetical clause of the section, as interpreted by this court in *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, at 385), then no other recourse need be had to Section 112(i) (1), and the question of what corporations were parties to the reorganization is a new and different question. We have attacked this *a priori* and upon authority in our original brief at pages 20 to 24, but in view of the position taken in the Commissioner's brief in the *Bashford* case it seems appropriate to add some further suggestions.

If Congress had intended that "a party to a reorganization" should mean only those corporations which perform the specific acts specified in Section 112(i) (1), we think Section 112(b) (3) would have been cast in an entirely different mold. Had the language of that section been:

> "No gain shall be recognized if stock or securities in either of the corporations between whom there is carried out a reorganization, as provided in Section 112(i) (1), are in pursuance of the plan of reorganization exchanged solely for stock or securities in such corporation or the other corporation"

we think this would have evidenced a Congressional intent to limit the application of Section 112(b) (3) to the particular corporations performing the acts described in Section 112(i) (1). But the language actually used by Congress refers to the exchange of stock or securities in a corporation "a party to a reorganization" for stock or securities "in such corporation or *in another corporation a party to the reorganization.*" This language, both by the omission of any reference to Section 112(i) (1) and in the use of the indefinite article plus the expression "another corporation" (rather than "the other corporation") makes it clear that Congress con-

templated parties other than the immediate transferor and transferee corporations.

Section 577 of Regulations 74 under the Revenue Act of 1928, as we pointed out on page 17 of our original brief, speaking of Section 112(i)(2), says:

> "This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which *doubt might arise.*"

If the government's contention that the only parties to a reorganization are those corporations performing the specific acts enumerated in Section 112(i)(1) is correct, there cannot possibly be any doubt as to the fact that "both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation" are parties to a reorganization, and there would be no reason for the specific enumeration of these corporations in Section 112(i)(2). It is indisputable that there is no more doubt as to the status of these corporations, under the theory of the Commissioner, than there is in the case of the acquisition by one corporation of substantially all the properties of another corporation. Yet there is no specific mention of the latter situation in Section 112(i)(2). It is not reasonable that Congress, when its sole purpose is to remove doubt, would mention one category and omit to mention another when both categories are equally free from doubt, or equally dubious.

Similarly, there would be no doubt as to the status of "a corporation resulting from a reorganization" if the bare performance of the acts set forth in Section 112(i)(1) is the sole test of whether a corporation is a party to a reorganization, for always the corporation which results from a reorganization has acquired either the

requisite amount of stock or property of another corporation or corporations.

Under what theory, then, does it appear that the two instances specified in Section 112(i) (2) give rise to more doubt than other cases? We submit that the test of corporate participation explains the language of Section 112(i) (2). Analyzed from the viewpoint of determining whether the necessary corporate participation is present, the two situations covered by Section 112(i) (2) at once stand out as raising the closest question. A corporation resulting from a reorganization, not being in existence at the time the reorganization was conceived of and entered into, might otherwise have been thought not to be "a party to a reorganization," since it actually came into existence after the conception of the reorganization, and is the outcome thereof.

The other transaction described in Section 112(i) (2) also concerns a case wherein there is no corporate action on the part of one of the corporations concerned, because where the B corporation, for example, acquires a majority of the voting stock and a majority of all other classes of stock of the A corporation, this may be done directly by the B corporation from the stockholders of the A corporation, without any action by the A corporation itself. It might be thought that after such a transaction the A corporation, never having acted in its corporate capacity in this matter, would not be "a party to a reorganization." Thus interpreted the presence of Section 112(i) (2) strengthens our contention that *participation* is an essential factor in the Congressional conception of "a party to a reorganization," and that Congress was not thinking solely in terms of the acts required in Section 112(i) (1).

The foregoing suggestions we believe sustain our claim that there is no statutory language appropriate to

support the contention of the Commissioner that in order to be a party to a reorganization a corporation must itself have performed the acts specified in Section 112 (i) (1). Is there any authoritative opinion from which such a rule may be deduced?

In our view the case of *Bus and Transport Corp.* v. *Helvering,* 296 U. S. 391, which apparently the Commissioner in the *Bashford* brief regards as the most nearly controlling opinion, does not even tend to support his position. While the opinion of this court sustains the conclusion of the lower court that the petitioner in that case "was not a party to a reorganization," the actual question decided was not who were parties to a reorganization, but whether there was any reorganization at all. The language of the opinion is positive and specific on this point in the statement: "nothing here, we think, even remotely resembles either merger or reorganization as commonly understood."

The exchange of securities in that case took place between Public Service Coordinated Transport Company and the Bus and Transport Securities Corporation. Public Service Coordinated Transport Company owned all the stock of C. Easman Jacobus, Inc., which in turn owned twenty-five hundred shares of Public Service Company stock. The C. Easman Jacobus, Inc. stock went to Bus and Transport Securities Corporation, which owned some shares of bus lines stock and gave them in exchange to Public Service Coordinated Transport Company. At the conclusion of the transaction Jacobus (an individual) owned the Bus and Transport Securities Corporation; that company owned all the stock of C. Easman Jacobus, Inc., which had as its sole asset twenty-five hundred shares of Public Service Company stock; Public Service Company had some undisclosed affiliation with Public Service Coordinated Transport Company, and Public

Service Coordinated Transport Company owned the stock of the bus lines which had originally belonged to Jacobus.

In considering this decision it is manifest at once that the whole arrangement was an obvious scheme to evade taxation, and not a *bona fide* business transaction. This is fully set forth in the opinion of the Circuit Court of Appeals for the Third Circuit, reported at 79 F. (2d), 509 and 510, and affirmed by the decision of this court. The opinion of this court made short work of the question, and the holding is that there was no reorganization at all. Since there was no reorganization there was no occasion to consider who might have been parties to a reorganization which was non-existent.

We think the only applicability of this decision lies in what might be considered an extension of the requirements with respect to a continuity of interest in transferred assets. Numerous decisions referred to in our original brief in this case at pages 22 to 24 indicate as an essential criterion in determining "partyship" to a reorganization the necessity that the stockholders whose stock is exchanged shall receive in exchange therefor something which evidences a continuing interest in the earning power of the same assets in which the stockholders originally had an interest by virtue of their stock ownership. The conception underlying this is primarily economic, and goes to the fundamental question of whether there has been in fact a *realization* from the sale or exchange of the stock. Where the exchanging stockholders receive in the exchange securities which render them in effect continuing partners in the enterprise in which they were originally interested, they have not in reality as to such new securities changed their fundamental relationship to those assets, but retain their interest in the earning power thereof. In interpreting the

words "party to a reorganization" this court and the Circuit Courts of Appeal have in several cases applied this basic test. This court in the *Pinellas* case, (*Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462), declared that "the interest in the affairs of the purchasing company must be more definite than that incident to the ownership of its short-term purchase money notes"; and in *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378, this court added the statement that such interest must be "definite and material" and "must represent a substantial part of the value of the thing transferred"; and then in the *Minnesota Tea Company* opinion this court expresses in a sentence the basic philosophy of this requirement, in the statement: "This much is necessary in order that the result accomplished *may genuinely partake of the nature of merger or consolidation.*"

In the *Bus and Transport Securities Corporation* case this court stated that neither party to the exchange acquired any "definite *immediate* interest in the other." Apparently it is from the use of the word "immediate" that counsel for the Commissioner in the *Bashford* case argue that the retained interest in the affairs of the purchasing corporation must be direct and not through any intermediate stockholding. This court did not say so in the *Bus and Transport Securities Corporation* case, and we do not believe that a fair construction of the language indicates that the word "immediate" was used in any such sense. If this were so the beneficiaries of a distributable income trust which held stock involved in a corporate reorganization would at once be taxable upon transactions plainly within the purview of the statute and as to which all other stockholders holding stock in their own names would not be taxable. When this court undertook deliberately in the *Minnesota Tea* case to define the character of retained interest which would satisfy the re-

quirement of continuity of interest, it did not use the word "immediate" or any equivalent, and it seems to us that this attempted argument from the *Bus and Transport Securities Corporation* case is seizing upon a straw and attempting to pervert the real meaning of that decision, which did not concern itself at all with the question here under consideration. Had this court intended to declare that any intervening "holdership" would prevent the existence of a "definite" and "continuing" and "substantial" interest in the affairs of the purchasing company, it would, we think, have said so in unequivocal terms; and the distortion of this single word in the *Bus and Transport Securities Corporation* opinion evidences to our mind the weakness of the Commissioner's position on the substantial question here to be decided.

POINT II.

GLIDDEN WAS A PARTY TO THE REORGANIZATION EVEN UNDER THE COMMISSIONER'S INTERPRETATION.

The Commissioner, at page 13 of his brief in the *Bashford* case, says:

> "But Atlas was not a party to these exchanges between the old companies and the new company which did constitute a reorganization and acquired neither the assets nor any of the stock of the old companies."

This statement indicates that the Commissioner cannot conceive of a corporation being a party to an exchange of assets, unless it acquires some of the assets or stock which are being exchanged. We suggest that a corporation which furnishes part or all of the consideration for the stock or assets exchanged is as much a party to the exchange as the corporation which receives the assets. Where a father contracts with a university for his son's

education, is not the father a party to the exchange transaction even although not the recipient of the instruction? The stipulation of facts in our case shows that Glidden furnished a substantial part of the consideration for the surrender of the Indiana stock by its stockholders. It issued $553,980.00 of its own prior preference stock directly to the Indiana shareholders and guaranteed quarterly dividends upon the Ohio stock and its ultimate redemption. It is clear that Glidden was an essential party to this three-cornered transaction and there could have been no exchange between the three corporations without the stock and other considerations moving from Glidden.

On page 19 of the brief in the *Bashford* case, the Commissioner says:

> "The agreement pursuant to which Peerless assets and stock were transferred gave no rights to Atlas and imposed no duties on it save guaranteeing the performance by the new company of some of its obligations."

Whether this statement is correct or not as applied to Atlas it is readily apparent from the stipulation of facts in our case that Glidden was given many rights and undertook many duties by the terms of its contract with the stockholders of Indiana. Among the rights given Glidden was that of determining the capitalization of Ohio, acquiring all the common stock of Ohio, and selecting the auditors to value the assets of the Indiana corporation; in return, Glidden undertook the duty of organizing and incorporating the Ohio company and of issuing and delivering its own securities and causing the issuance and delivery of the Ohio securities, and ultimately of causing the assets of Indiana to be transferred to Ohio. It also guaranteed the dividends on and ultimate redemption of the Ohio preferred stock, as above set forth.

The Commissioner in his petition for a writ of certiorari in *Helvering* v. *Bashford*, recognized the importance of Glidden in this case and on page 12 of his brief said:

> "In that case [Groman] as in the instant case, the corporation which motivated the entire reorganization scheme furnished the necessary cash and stock to carry out the reorganization and after the consummation of the plan was in control of the new company."

Hence, if the creation of rights and duties under the reorganization agreement be determinative of the status of the particular corporation, Glidden clearly satisfies this test.

At page 21 of the Commissioner's brief, the case of *Union Trust Company* v. *Heiner*, 18 F. Supp. 801 is cited with the comment:

> "The court there held that the parent was not a party to a reorganization in which the assets were transferred to a subsidiary."

This is another example of the emphasis which the Commissioner places upon the entity to which the assets are transferred. The facts of the *Union Trust Company* case are that the General American Tank Car Corporation, which was a going concern organized under the laws of West Virginia, acquired all the assets of the Federal Tank Line by giving in exchange common stock of the General American Tank Car Corporation of New York, which owned control of the West Virginia corporation. The issue in the case, as interpreted by the District Court, was whether there was a reorganization so that the stock of the New York corporation was received without recognition of gain. The court said:

> "Had the West Virginia corporation given its own stock for the property of the Pennsylvania corpora-

> tion, there would have been a reorganization under the authority of *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378 * * *, but as the West Virginia corporation gave not its own stock but that of the New York corporation, there was no reorganization, even though the New York corporation controlled the West Virginia corporation. *Bus and Transport Securities Corporation* v. *Helvering,* 296 U. S. 391. * * *"

In analyzing this case it is first apparent that the transferor acquired no stock in the transferee, so that under the rule of the *Minnesota Tea Company* case, 296 U. S. 378, there was no reorganization. However, even had the West Virginia corporation transferred part of its own stock to Federal Tank Line in addition to stock of the New York corporation so that there would have been a reorganization, still the New York corporation would not be a party to the reorganization, because its stock was furnished not by it but by the West Virginia corporation. Furthermore, so far as the opinion shows, the New York corporation did not in any way participate in the transaction with Federal Tank Line.

We agree with the statement several times repeated in the Commissioner's brief in the *Bashford* case that "one corporation is not a party to a reorganization * * * merely because another corporation, which it controls, is a party." We have never contended that the mere relationship of parent and subsidiary in and of itself is sufficient to satisfy the statute. Rather, as pointed out in our original brief, the two *criteria* of participation and continuity of interest must both be satisfied.

POINT III.

THE CORPORATE ENTITY OF OHIO MAY BE DISREGARDED.

This question was fully argued and the applicable authorities discussed at pages 28 to 38 of our original brief.

In the brief filed by the Commissioner in the *Bashford* case there is little discussion of the point but the position is taken that the court should adhere strictly to what is concededly the general rule, that a corporation is an entity distinct from its stockholders. In the *Bashford* brief the Commissioner says:

> "The necessity of maintaining the identity of parent and subsidiary is doubly apparent in the case of the reorganization provisions of the statute, where the degrees and types of corporate control and reorganization are defined with meticulous precision."

With due respect to the author of the brief, this seems to us a complete *non sequitur* as well as an incorrect statement of the fact with respect to the taxing statutes.

It is perfectly obvious that "control" is defined in Section 112(j) solely to explain the meaning of that word as used in Section 112(i)(1)(B) in determining whether the fact of reorganization exists in a particular situation. There is no justification for assuming that Congress intended this definition to be used for any other purpose. The very act of defining the "control" of one corporation by another presupposes a separation of the corporate identities.

As used in those cases in which the question of disregarding corporate entity is involved "control" is a question of fact.

In our case it is apparent that Glidden contracted to create and did create Ohio; that it issued its own stock to the stockholders of Indiana as part of the consideration by which the Indiana stock was transferred to Ohio; and that it operated Ohio as a department of the business of Glidden. The preferred stock of Ohio which was not held by Glidden was non-voting, so that the entire

actual control of Ohio was in Glidden. The preferred stock was subject to redemption at any time; and Glidden guaranteed that it should be redeemed. (R. 12) For all practical purposes, therefore, Glidden's control of Ohio was absolute. It is apparent that Ohio was a mere instrumentality of Glidden, and the situation is squarely within the decisions cited on this question in our original brief.

While the statutory definition of "control," as above pointed out, seems to us completely irrelevant to a discussion of whether the corporate entity of Ohio should be disregarded, we might point out that if it is thought to have any application to this question Glidden and its stockholders, both before and after the exchange of securities involved herein, were in 100% control of Ohio. Prior to the transfer of Indiana's stock to Ohio, Ohio had only one stockholder, Glidden, which owned its entire outstanding common stock, which was all the stock then issued. After the transfer of Indiana's stock to Ohio, Ohio's stockholders consisted of Glidden, still owning the entire common stock, and Glidden's stockholders, owning the entire preferred stock of Ohio; so that the situation then was squarely within the language of Clause (B) of Section 112(i)(1). We think, however, that this is rather beside the question, and suggest it only because of what seems to us a confusion in the Commissioner's brief in the *Bashford* case upon this question.

In the same section of the Commissioner's brief in the *Bashford* case is cited the case of *Union Trust Co.* v. *Heiner,* 18 Fed. Sup. 801, a decision of the District Court for the Western District of Pennsylvania. We do not think that this case (even if it were authoritative in this forum) is of any assistance in determining what circumstances are necessary to warrant disregarding the cor-

porate entity of a subsidiary corporation, because the question was not discussed and none of the facts are set forth in the opinion.

CONCLUSION.

For the foregoing reasons and those stated in our original brief on the subject we submit that the Glidden Company was a party to the reorganization which concededly occurred here; that its stock, issued by it to the stockholders of Indiana in exchange for their stock in Indiana, constituted stock in a corporation which was a party to a reorganization; that the exchange was in pursuance of the plan of reorganization; that such stock was received without recognition of gain or loss; and that the decision of the Circuit Court of Appeals for the Seventh Circuit holding otherwise should be reversed.

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